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**Transcription of Shorthand Notes of Carol Gordon - Finance Committee,**  
**June 20, 1997**

NOTE from transcriptionist:

( ) means I did not write anything in that spot at the meeting.

\_\_\_\_\_ means I cannot read it now.

\_\_\_\_\_ ? \_\_\_\_\_ means I do not know who said it.

10:40 a.m.

No additions to minutes.

III. A. Minutes approved.

III. B. Financial Statements for March 31

Abdelhak: Page 10, consolidated statements. Look at the lower part of the page - you will see that there is a significant level of increase in the provision of services. Admissions, discharges, and while patient days are not at budget levels, the bulk of the payors for the system remain on a discharge basis, so the activity is ahead of budget. There are a couple of useful results that can be gleaned from Pages 11 and 12, specifically Page 11 - you will see how AGH is doing as compared to budget compared to last year, see how AUMC is doing compared to budget and AIHG is significantly at variance with budget and is part of the more critical issue that we must deal with. The University on Page 12 is another one of the priorities in terms of the resolution of critical importance. They continue to be the main detractors from the results that we aspire to get; hospitals continue to make progress in spite of incredible competition.

AIHG has improved because of excellent rates that David negotiated for risk contracts and because of the excellent results of the executives in AIHG, specifically, Dr. Kaye. We anticipate that we are on course for improvement in AIHG. At the University, the biggest single problem we have had is that there has been an enormous erosion in the critical fee departments. The revenue is 30% reduction in some departments. When we look at the budget for next year, you will see that some of the hospitals in the Delaware Valley, you will see that some of them are experiencing the same decline. The erosion at the medical school is practically across the board as a result of payors changing the rates without consultation. Basically follow Medicare rates, and they do not negotiate with anyone. In the hospital sector in the Delaware Valley, it is more because of the

adjustments in Medicaid. Obviously, if it arrives in Pittsburgh as scheduled, it will have the same effect on the Pittsburgh hospitals. The management teams are performing, in my judgment, superbly. Faculty and physicians are doing incredible jobs in the market place. David will deal with the results of those activities and the balance sheet so that we can proceed with accepting these statements.

McConnell: Apologize for the lateness of the books. Given all the changes in reimbursement, management teams worked until the end to complete their plan. Everyone has put a good effort in getting things out and we will take more time for questions. Page 10, statement of ( ). Reminding you of what is now in AHERF. AHERF effective January 1, we started to include Forbes, effective March 1 we included Allegheny Valley in AUMC. Focus on the revenue section, budget \$1.1 billion, we are within ( ) of budget. Admissions 1% ahead, days 4% below. With adjustments in payor mix, we are close on the revenue side.

Investment income is significantly ahead of budget year to date, accounted for because the markets have had a banner year again. We have also been readdressing some of our asset managers and asset mix and that creates a gain that we are required to book. We are substantially ahead, \$39 million ahead of budget. Expenses - salary, etc., are ahead of budget. Bulk is in AIHG; added on practices show the variance. Overall, our net income is \$13.1 million for end of March. Budget 3.5; We have made our year's budget, and anything else by the end of the year is gravy. Page 13, highlight how those activities affect the balance sheet. Current assets: Grown significantly - talked about captive insurance company and bond documents. Page 10, revenue has increased \$191 million. We are making gains and progress in the receivables management area. Book of business has increased.

PP&E net is \$700 million for capital purchases during the year of \$66 million, offset by depreciation and amortization. Spending has gone along with budget and capital equipment, and for next year there are significant reductions in planned capital spending. In long term debt, there is an increase because of merging Forbes and Allegheny Valley balance sheets. We have accounted for them as acquisitions. Talked about how we took in the PPE asset value. Overall the balance sheet is different, and it will continue to change with additional acquisitions.

Gargalli: Page 11, question about ( ).

McConnell: From a financial statement perspective, yes. From business perspective, some

investment gains are arbitrary pools, so the expenses of debt are not there so the net operating loss is still significant.

Barnes: Statements continue the trend of the last 18 months so that we are in the black. Hopefully, Fiscal Year 1998 will see an improvement.

Resolution, page 7.

### Budget

Abdelhak: Apologize for the delay of agenda. We were delayed all around in getting the budgets out for each entity. That is a function of the fact that we brought Graduate in in May and had to assure that Graduate effect was understood and we had to re-state the system expenses and system contributions. Story is the same. I addressed the budget from an operation point of view when we talked about financial statements for March. It is an extraordinarily challenging time. We have management teams that I would stack up against anyone in terms of fortitude and commitment in making whatever changes necessary without harming quality of care or quality of education to improve productivity of units and results. Included in here is a substantially greater overall revenue on a per unit basis and the effect of them are phenomenal. Level of activity budget on Page 36 should give you some sense of the growth in market share and it is substantial. For the first time, St. Christopher's Hospital for Children is showing a reduction in its number of cases and that is because of our interest in being conservative about the effect of the opening of Temple Hospital on St. Chris. We may see some erosion because of the ER. We will attempt to overcome in 1998, but certainly in the future. You will see a significant improvement in activity in AUH-Centennial, and that is the result of Dr. Kaye and his management team doing an incredible job including into the system from other systems. Activity in New Jersey is growth due to the fact that we now have a community hospital where our physicians in AIHG can admit. On an absolute basis, we are showing 7200 cash growth in the market that diminishing significantly, there is the market share is significantly higher. Acuity level at each institution is either holding steadily or increased. AUH acuity is not really reflective of the two academic medical center hospitals because they include two community hospitals. You will see significant improvement in Accounts Receivable again, attributable more to David and Joe Dionisio. They are working as hard as they can to deal with the issues of Accounts Receivable to increase cash flow. As you know, we have suffered because of the consolidation, and I think David and his people anticipated that. We have overcome that and there is evidence that it is turned around and we will reap the benefits of the investment in the consolidation. Any questions?

Hilton: Getting back to Claire's point on Page 39, we show next year's investment income of \$34 million and if you take that out you are at break even for operations.

Gargalli: The allocation of the investment income throughout the system which shows on that line on Page 39 - the portion that is allocated to the institutions--how is that?

McConnell: Based on their allocations and cash balances. Talked about portfolio of each institution - directly reflective of each institution - run it on corporation by corporation basis. Just to compare AGH to AUH - talked about the investment income in each.

\_\_\_\_\_ ? Is that because of some historical endowment that has followed to the present?

McConnell: Yes. AGH has some endowment and we have built up funded depreciation balance.

Abdelhak: We have deliberately maintained a leverage that will retain an "A" rating at AGH, but in the process we have added to the funded depreciation balance so offsetting the revenue of \$7 million or whatever the number was is an expense so the net effect in terms of its effect on operations is not the total amount of interest income so the expenses associated with that borrowing is also in their expenses. When you are making comparisons, I wanted to be sure you understand that if you need it how the investment income would not be significantly different.

Kaye: There are a lot of university hospitals in the country that support medical schools from the bottom line so that they show a better profit. How profitable would our hospitals be if we did that? A lot. Think we should remember that when we compare ourselves to other institutions when bottom line is very high but after support of school it is much lower.

Abdelhak: You are correct, and you would have to add \$120 million of more profit on a consolidated basis to compare with UPMC or University of Pennsylvania or whatever. The interesting thing is that in some of these Universities, the academic enterprise continues to be on a cash basis, and that is a curious way of accounting. We have avoided that sort of thing, but had we adopted that sort of approach, the bottom line here would be \$154 million.

Gargalli: Page 38, 900 increased revenue. I would ask in the AIHG budget for next year we just saw a \$300 million increase in the risk contract budget. Are the risk contracts lesser in the system that would make the portion of that increase related to risk contracts higher?

McConnell: It is about 1/3 of the increase. To highlight the statements: Page 38, about 1/3 of the increase is the increase in risk contracts. The bulk of the contracts is related to the Health America transaction in Pittsburgh. What you see is an improved operating result compared to last year. We are projecting \$52.7 million less in investment income than this year, so the shift to true operating results is improved. With Health America, we have built in a \$30 million profit, so we will end up with a profit in Pittsburgh. We also now include the business of the old Graduate Hospital. We expect ( ) admissions system wide, 4% increase. So there is also an expense page that in most of the organizations does not include salary adjustments that are not contractual and have tried to maintain a flat budget for next year. In addition, the revenue variance ( ). Talked about increases in revenue that we have not had earlier. Pressure we have on rates is tremendous. Balance sheet: With 97 patient Accounts Receivable balance of ( ). There is a serious improvement in the receivables balance sheet. That equals to 68 days of revenue in receivables. St. Christopher's is where we have the most difficult challenge, so they are really tracking their revenue. With respect to expenses, we are showing an improvement of about \$40 million in that piece of the balance sheet. A lot of that is funded depreciation money and a lot in Pittsburgh.

PP&E - Capital spending will be reduced from what a lot of the organizations requested. Page 42 - largest capital is in AHERF. Bulk is the continuing investment in Information Services, which support Lifetime Clinical Record, etc. Want to reduce paper and manpower. Balance sheet also shows on long term debt that this year it will reduce, so our principal repayments next year are \$31 million in cash and some would move up to current portion. Reduction in long term debt next year. Talked about debt on financial statements on historical basis. Graduate added ( ), and AUMC added \$120 million. Talked about assets and how much more debt we acquired. We acquired these organizations for the value of their debt. Has allowed us to get cash for Medicare recapture. As we deal with the rating agencies, they think that was a positive move rather than a negative move.

Neuwirth: Page 39 - Could we get some discussion on the salary, wages, and fringe benefits about the system wide policy as to compensation?

Abdelhak: For the most part, the approach has been to defer any salary adjustments until October 1 until we have at least one quarter under our belt to insure that the results in the first couple of months are consistent with our budget. It is usually in the range of 3%. Not across the board; it is merit based. The fringe benefits issue - look at them on a year to year basis - the increase is attributable to the larger

number of employees in AHERF as reflected in this budget. Our philosophy in compensation and benefits is to do as much as we can for everyone within the realm of what we can afford. Each entity was encouraged to use up to 5% of their total compensation to make adjustments, provided they achieved their objectives. Adjustment is commensurate with what is happening in the marketplace. They are typically encouraged to do as much as possible as a matter of policy.

McConnell: I think if we look at the goals that the Committee set for budget development (he reviewed them)..... 5%, 5% plus accounting adjustments..... University would break even, AIHG 25% improvement. From overview, we missed 5% range in some organizations. Sherif is satisfied that every one of the entities has submitted a budget that they believe is attainable, and those that did not meet the 5% return were satisfied with their reasons behind their inability to do so.

Gargalli: Having sat through three prior boards of the tier in the east, on the 97 projections, Dave, another difference of what we were given as projections for year end - some are off a little, some more than others. Where do those differences come from because they impact the change?

McConnell: Timing and process. We have developed budgets with the individual boards based on older information. Had opportunity to make adjustments to the budgets as we reviewed various entities and how these change when they came together in the AHERF budget with newer information.

Barnes: Any questions?

Gargalli: Page 42 - of the \$69 million system wide, how much is in Information Services?

McConnell: About half. There are two major activities: Lifetime Clinical Record and overall development of Information Services plan.

Dionisio: \$25 million - Next year is the biggest expenditure year of a three year plan.

Talked about where the Information Services is in the individual budgets. AUH, AGH.

Barnes: I think it is a budget that represents progress. If we can achieve it, it is a substantial improvement over what we will see for 1997. I hope we can achieve it because the environment out there is not too friendly, and it is nothing to write home about.

- Abdelhak: Will ask David, Joe, Chuck to talk about what they have included here as assumptions for Medicare because it is not clear at this point about what will happen with Medicare.
- Dionisio: Have provided for 1% increase in reimbursement effective October 1. Current view is that there won't be any action in Congress to change what has been their historical practices. Historically, our increases have changed about 2.3%.
- Abdelhak: 1.0% increase in the budget.
- Morrison: We are closer to flat with the current year. 1.3% increase in base DRG rates; 4% reduction in indirect Medical Education, balance of those two is close to a wash. We are making up that in volume.
- Roth: 1.8% effective October 1 in DRG rates.
- Abdelhak: There is a high likelihood that there will be an overall reduction. We will keep you posted on what will happen with Medicare. The position that each of these organizations has taken would be viewed conservative. When you talk about whether we can meet the budget, I want to be sure I can tell you where there may be variations.
- Abdelhak: Moved.
- Seconded.
- McConnell: Given where we are in terms of the calendar, each operating unit's budget has been reviewed by their board and will be recommended to AHERF.
- Budget passed.

IV. A.

- Martin: Page 45 - Management Report on Investments - This is information through the first calendar quarter of the year. As of that time, the system's investment portfolio was at \$99.8 million. Significant growth in the assets in terms of the capital returns coming out of the markets as well as the affiliation strategy that we have undertaken. Page 54 is a representation where we have allocations by entities. First graph reflects market values. AHERF continues to hold its historic position. For the first time, we have a reflection of AUMC with their assets reflecting their successful historic performance. In terms of asset class, we are at

48%-49%. In terms of what kind of mix we have in the organization, we have accounts spread between funded depreciation, endowment, and assets. Page 45 - We have made significant strides in finalizing program. Realigning portfolios which will allow us to manage these funds on consolidated basis which will let us bring in new portfolios in the future. Have moved around assets and have done so efficiently and economically.

Regarding performance, direct our attention to the AHERF Pension Master Trust. First quarter was difficult in the financial markets, which resulted in ramifications. Pension funds realized positive return. Have had good relative performance. Going forward, we can continue to expect a good relative performance. Beginning to phase out exposure to real estate. Page 46 - we had good relative performance for all periods. Page 47 - funded depreciation returns Pittsburgh only - there are some difficult markets here. Relatively good performance vs. pension market. Page 48 - Endowments for Pittsburgh only - we have the performance, not as good as we would like, but for three years it is about where we want it to be. Page 49 - Special Purpose Funds - these tend to be shorter term in nature - funds allocated to specific purposes. We are managing them accordingly. Good relative performance. Page 49 - reflected returns for AHSPIC - this is a portfolio managed, taking into account the liabilities for which AHSPIC was created. Duration of assets matches the liabilities. Page 51 - Have some of the Forbes funds reflected for the first time. Some include Graduate and Allegheny Valley Hospital for the first time. This information will be in the reports that we see in the future. These funds will be pulled into AHERF Master Trust portfolio.

No questions.

Abdelhak: Comment: At some point during the meetings of the boards, we sought approval in the Delaware Valley to sell non-essential assets and lease them back, and we had proposed to do so so as to increase Delaware Valley cash position in light of some of the oppressing cash requirements for AIHG and other issues. All in all, because of the amount of leverage that is in the Delaware Valley, they will not enjoy an interest cost that is comparable to what AGH has done in the past. My view that we need to consider and act on a policy to utilize intercompany financing in lieu of what alternative financing may be for the Delaware Valley provided that financing happens that it is official in its nature and that the rate of interest will be comparable to the reference from which the loan is made. I think that is productive and I would like some discussion of it at this point and what I would enjoy is that you would support and recommend it to the AHERF Board because I think we need to develop alternatives in the Delaware Valley. They are going through a great deal of upheaval, and I think we need to support them.

Barnes: Should make conclusive recommendation now or should we study?

Make conclusive.

Abdelhak: If we have a loan document for an intercompany loan and if the return would be at the end, and the principal would be made over a specified period of time, I think that would provide us with significant flexibility. I think it would benefit AHERF and its entities and some of our entities would be helped in a dramatic way.

Gargalli: Is this instead of the sale and leaseback?

Abdelhak: Yes. No one likes the deal. I am trying to come up with an alternative. Take any principal. There would be written agreement as to return of the principal; interest cost would be at the reference fund from wherever the funds are used. About \$75 million.

Neuwirth: Is this any different than any transactions similar in nature that have gone on over the last several years?

Abdelhak: Usually we clean them up by June 30, and I am not talking about this. I know it is not usual, but this is an unusual circumstance. I do not want to direct him without the benefit of your support.

Barnes: Hesitating. In another environment I have been up this here fraught with mines. They are: a lot of these funds are not subject to a businessman's rule of prudence. When you raise that issue this thing is sticky. This is an issue that is an extremely sensitive and difficult problem; when you lend money to yourself there is thin ice.

Abdelhak: If I limit the amount and duration, will it make you any more comfortable? I need to get you to do this by June 30. Asked them to approve it.

\_\_\_\_\_ ? Where would it come from:

Abdelhak: I don't know; I will leave it up to him.

Barnes: How long?

\_\_\_\_\_ ? Leave it up to David. As short a period as possible.

Abdelhak: Mr. Chairman, I am going to move approval to give me that support so I can direct it accordingly.

Gargalli: Discussion. Sale/leaseback.

McConnell: We would receive the gain and some we would have to set aside.

      ? Wondering if there is a smaller number.

Abdelhak: Said there may be. I said up to \$75 million.

Neuwirth: Seconded.

Barnes: Why don't you want to sell and lease back?

Abdelhak: Interest rate.

McConnell: Non-clinical assets. Off campus. We need to lease them back. The best we have been able to negotiate, we are still around a 9% interest rate. The transaction makes sense, but when you start talking about a 9% interest rate, it wouldn't make sense, and at the end of 20 years we would have to acquire the assets back and if we could find a better way, we would like to.

Barnes: Why is timing such an issue?

Abdelhak: Because it doesn't clean up anything he has done on an intercompany basis during the year. He will have to show it in an audit so he either gets the cash from the sale and lease back (bad idea) or we give him authority to do so and thereby facilitate his recording it on the books in the audit in the manner.....

Abdelhak: I will report back to you in further detail as to those two subjects and what they represent for the institution, and I am convinced that it substantially beneficial to request what I am doing and I regret that I have to do this without even a piece of paper.

Hilton: The deadline is by the end of June. To clean up is David's problem. But you don't necessarily need the whole \$75 million.

Abdelhak: If it is any comfort, much less than the \$75 million will be used by the end of June.

McConnell: We are asking for a ceiling that was consistent with what we were asking for in our prior request.

Barnes: This is true. Maybe we should appoint a subcommittee to work with you on this.

Abdelhak: Yes, we would be delighted. If you could give us the approval and work with you to satisfy you.

Neuwirth: Perhaps you could get approval today and then come back by telephone.

Barnes: Subcommittee: Barnes, Leonard Ebert, Clair Gargalli. Three will work with Nancy and David and have a phone meeting between now and June 30. I don't think there is any hesitancy in looking at the question, but I think it is a mine field laden issue.

Abdelhak: We did the same thing with the acquisition of ANI. We repaid the principal ahead of time and chief pool of resources were used. Were not affected because we used the reference fund as an interest rate. It would be a problem if you had a group that has not done it in a disciplined way.

\_\_\_\_\_ ? Anyone object to that procedure?

\_\_\_\_\_ ? Approved.

\_\_\_\_\_ ? Cash disbursements.

\_\_\_\_\_ ? Anything else?

McConnell: Behind Tabs 5 and 6 I have included some outside information on pension fund performance and an article that our Vice President of Billing had published recently. It is interesting that over any period of time we were in the top third of pension funds in the area. With respect to receivables, business people are helping us to turn the tide in a positive way.

\_\_\_\_\_ ? Any questions?

Adjourned, 12:00.

cg  
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